

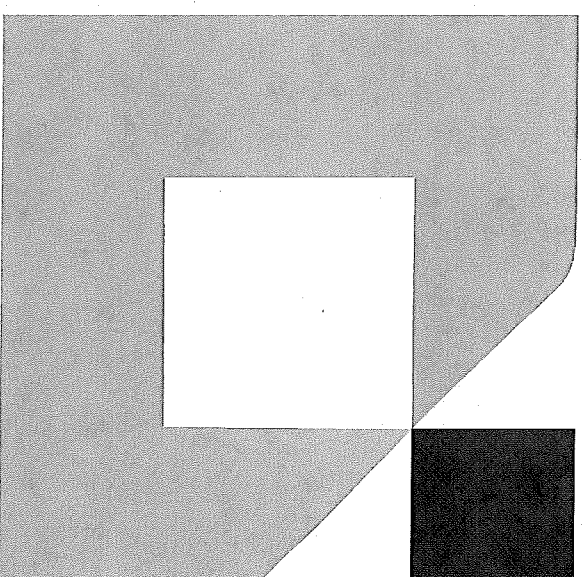
North Carolina Beach Plan Presentation

Presentation to the North Carolina
Legislative Research Commission
Subcommittee on Property Insurance
Ratemaking

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Overview of Presentation

- Introduction
- Background
- Overview of Milliman Analysis
- Major Findings
 - Beach Plan exposure
 - Comparison with Prior Report
 - North Carolina rate level
 - Potential impacts on NC insurance industry
- Conclusions
- Limitations

Introduction

- Beach Plan Analysis for PCI
 - Conducted by Milliman – Independent actuarial consulting firm
 - Purpose and Scope
 - Analyze the impact of HB 1305 on Beach Plan funding of hurricane exposures and the residual exposure to the NC Property insurance industry.
 - Analyze the overall Beach Plan exposure and the effect of North Carolina's rate level
 - Basis
 - Publicly available data from Beach Plan and other sources.
 - Milliman is available to answer any questions regarding the analysis

Introduction

- Prior Milliman Report
 - Commissioned by PCI
 - Dated October 10, 2008
 - Presented to the North Carolina General Assembly on October 16, 2008
- General Results:
 - Showed Beach Plan was susceptible to severe hurricane events that could result in billions of non-recoupable assessments to voluntary property insurers. These assessments could be large enough to threaten the solvency of smaller insurers.
 - Showed there was no system in place to finance large surplus deficits and gave examples of the effect of recouping deficits using varying assessment bases.

Introduction

North Carolina House Bill (HB) 1305 – Passed in 2009

- Provisions that affect the Beach Plan's exposure to hurricane loss include:
 - *Surplus must be retained to maintain Beach Plan operations*
 - *Pay losses*
 - *Purchase reinsurance*
 - *Pay operating expenses*
 - *May not be distributed to member companies.*
 - *Minimum named storm deductible for wind and hail coverage of 1%.*
 - *Maximum coverage limits of \$750,000 for homeowners and dwelling policies (previously set at \$1.5M)*
 - *Contents coverage reduced to 40% of building value (previously 70%).*
 - *Beach Plan rate level set at 5% above approved voluntary market rates for separate wind and hail coverage and 15% for wind and hail as a part of a homeowner's policy.*
 - *Beach Plan may institute a Catastrophe Recovery Charge that will apply to all NC property policyholders (including Beach Plan) subject to the following:*
 - *Catastrophe Recovery Charge may only be implemented through the NC Insurance Commissioner.*
 - *Charge may only be proposed once member companies have paid \$1 billion in assessments.*
 - *Charge shall not exceed 10% of the annual policy premium.*

Background

North Carolina Beach Plan

- North Carolina Insurance Underwriting Association (NCIUA)
- Formed in 1969 (along with FAIR Plan) to make property insurance available to NC residents unable to purchase insurance through the standard insurance market.
- Available only in the Beach and Coastal areas.
- All P&C insurance companies who do business in North Carolina participate in funding the plan and sharing any losses or profits.
 - Deficits must be funded via assessments on insurers and the Catastrophe Recovery Charge.
 - No mechanism currently exists for insurers to recoup amounts assessed.
 - The practical implementation, timing, and initial financing of Catastrophe Recovery Charge has not been determined.

Overview of Milliman Analysis

2011 Milliman Analysis

- Update of 2008 Milliman analysis.
- Estimate 2011 hurricane losses to Beach Plan under 7 scenarios using RMS catastrophe model.
- Estimate losses retained after reinsurance is applied based on 2011-2012 reinsurance program.
- Project Beach Plan surplus as of September 30, 2011
- Subtract retained hurricane losses from projected surplus to estimate final surplus or deficit.
- Estimate impact to voluntary insurers based on current assessment structure as described in HB 1305.

Beach Plan Issues

Issues identified in the 2008 Beach Plan analysis:

- Relatively low surplus
 - Moderate severity storms would result in deficit.
- Inadequate reinsurance coverage
 - Prior coverage was at 1-in-49 year PML with the majority covered by member companies.
- Increasing volume
 - From 2004 – 2008 insured values grew an average of 40% a year.
- Unlimited assessments on member companies
 - Large assessments could threaten solvency of some insurers.

Beach Plan Issues

2009 NC legislation has addressed some major issues:

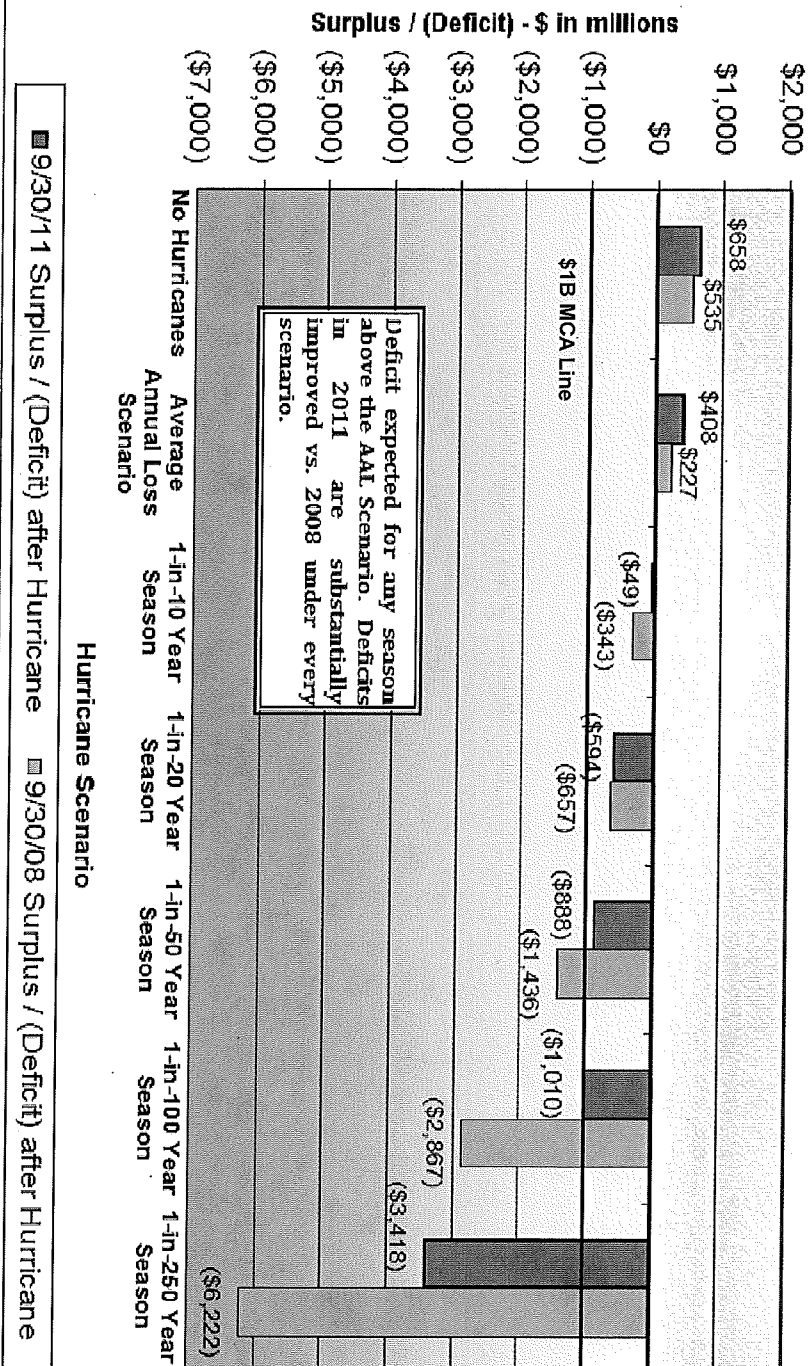
- Restrictions on distribution of profits to member companies increases available surplus.
- Resources available to purchase greater reinsurance coverage.
- Coverage restrictions and mandatory deductibles lower modeled PML.
- Limiting coverage amounts to \$750,000 makes some risks ineligible (\$1.5 million limit prior) and further reduces PML.
- Assessments to member companies are now limited.

These actions have limited the rate of growth, but have not significantly reduced the overall Beach Plan volume, which in 2011 is about 50% of NC coastal insured value.

Comparison with Prior Report

Beach Plan Deficits

Surplus / (Deficit) after Hurricane at Fiscal Year-End 2008 and 2011
North Carolina Beach Plan

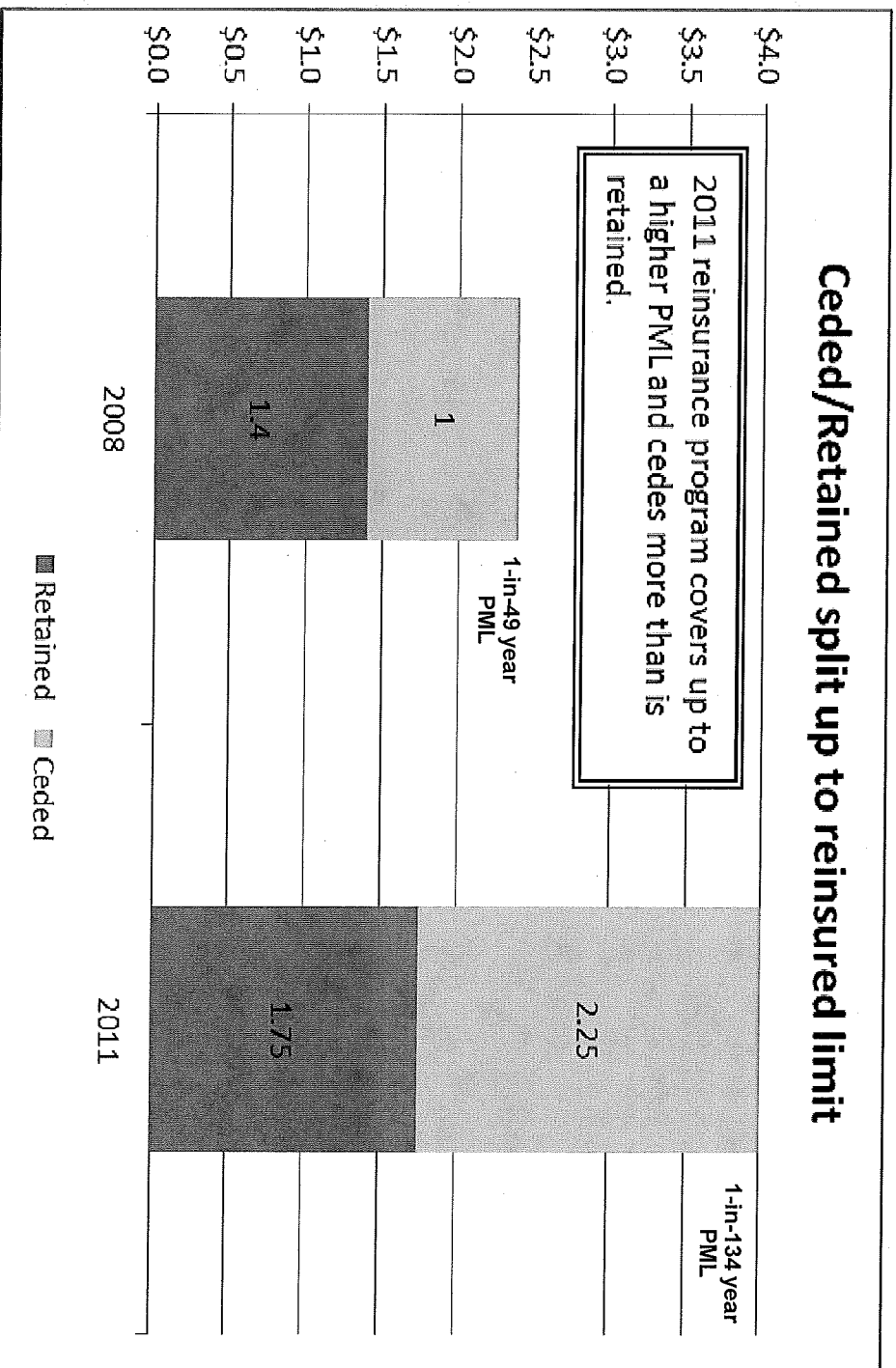


2011 deficits taken from current Milliman analysis using the current reinsurance program and current estimates of surplus and hurricane losses. 2008 deficits taken from prior Milliman analysis using the 2008 reinsurance program and prior estimates of surplus and hurricane losses.

Comparison with Prior Report

Reinsurance Program

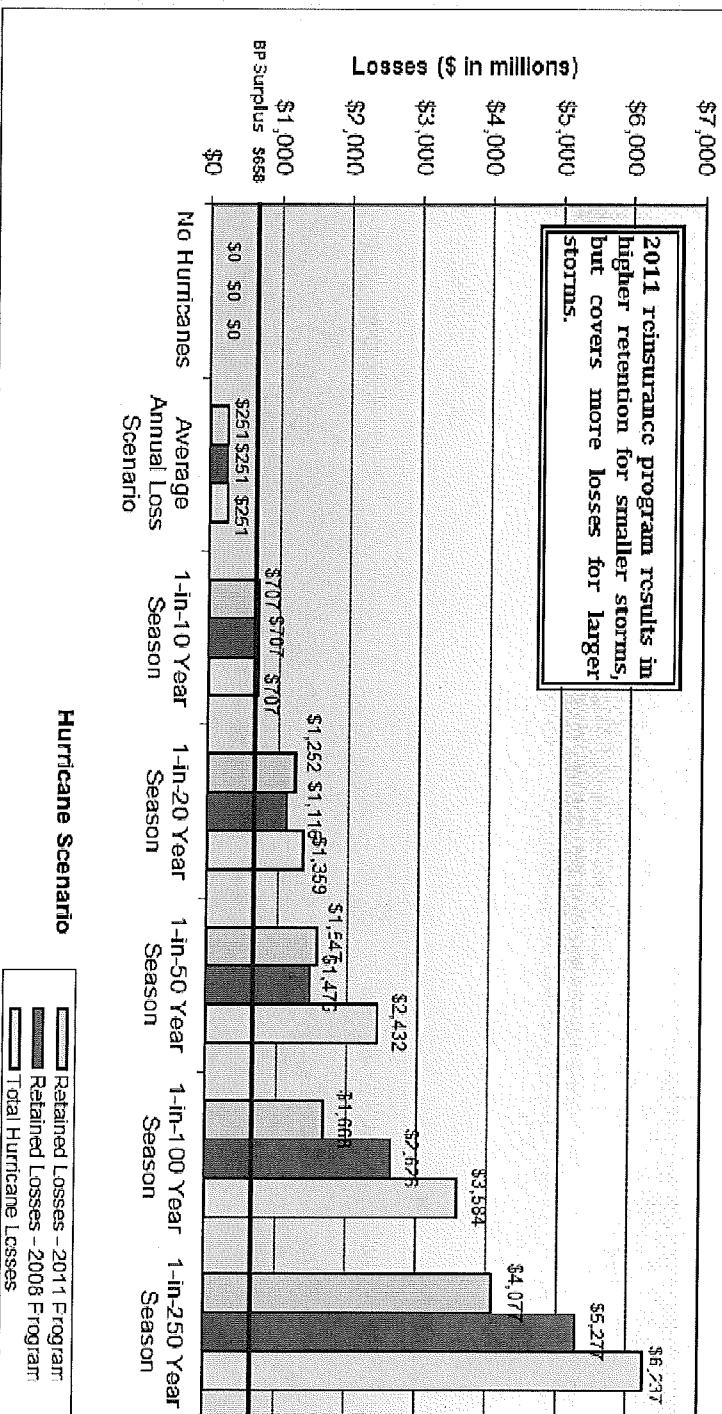
Ceded/Retained split up to reinsured limit



Structures are simplified for comparison purposes. Retained layers include member company assessments and co-participation.

Comparison with Prior Report Reinsurance Program

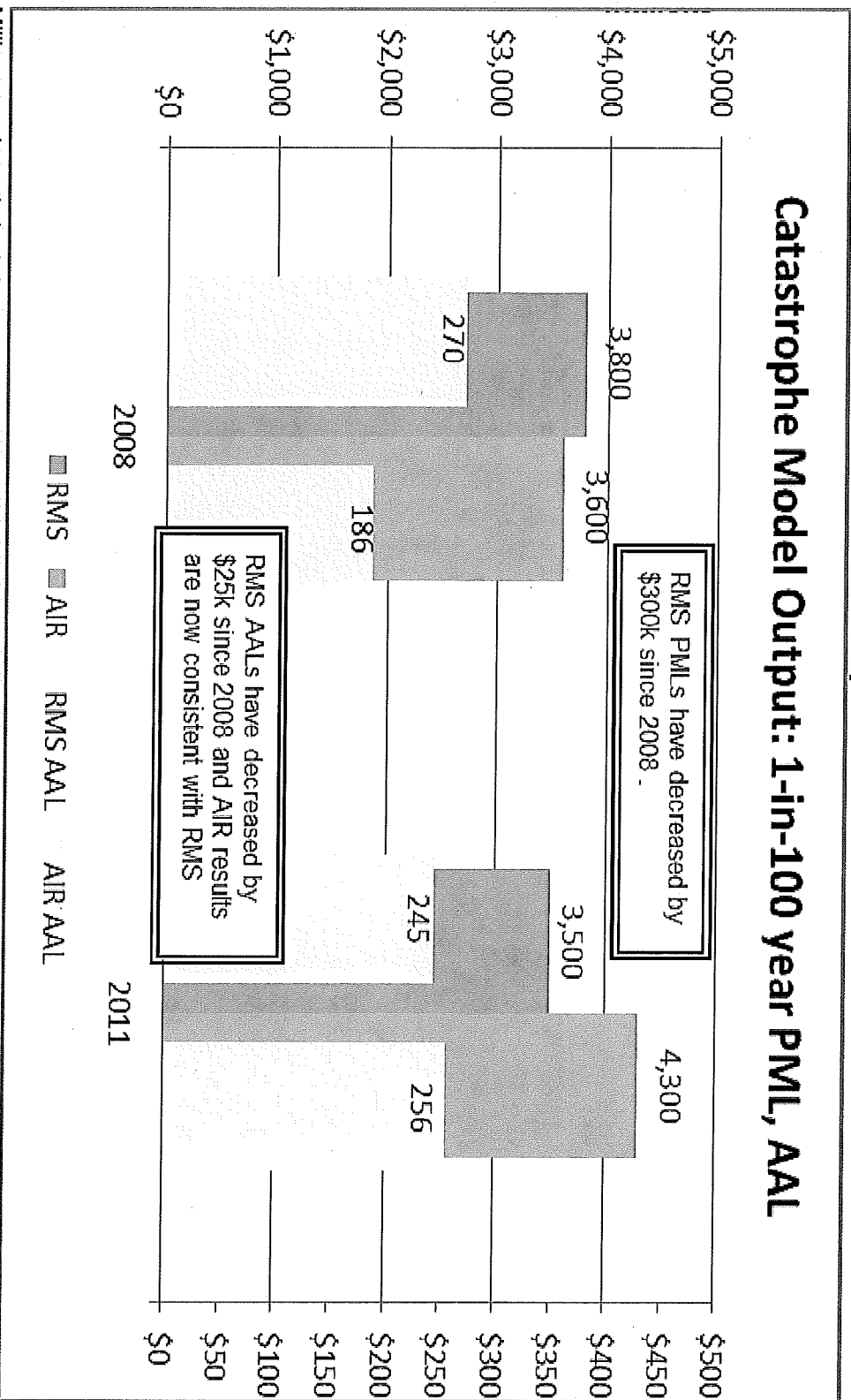
Estimated 2011 Hurricane Losses by Scenario North Carolina Beach Plan



Comparison of 2008 and 2011 reinsurance programs assuming the current modeled losses. Ceded amounts for Beach Plan may be less than the maximum indicated by the reinsurance program which also covers the FAIR Plan.

Comparison with Prior Report Catastrophe Model

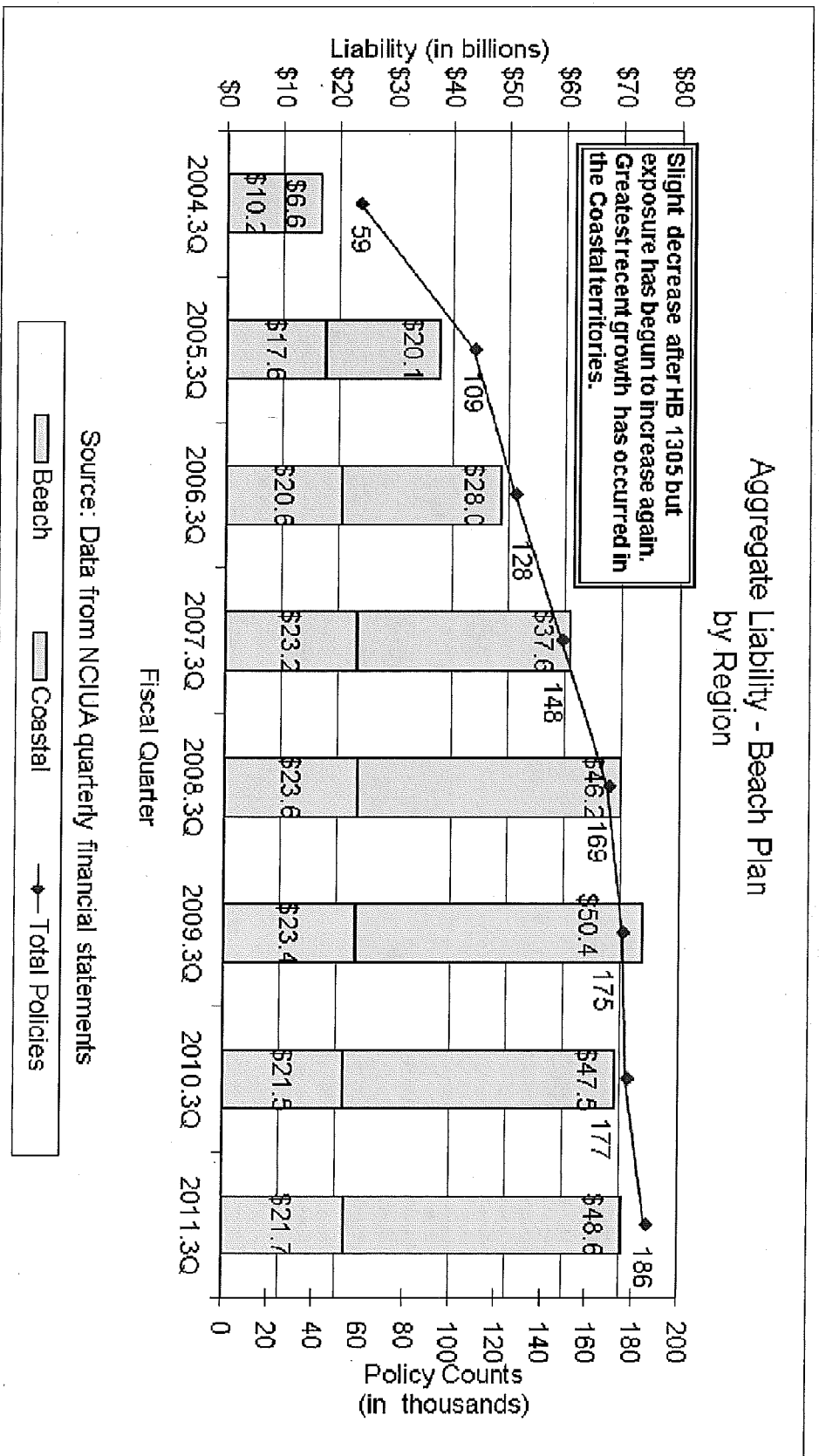
Catastrophe Model Output: 1-in-100 year PML, AAL



Milliman analyses in both 2008 and 2011 are based on RMS model. Deficits by scenario and comparison over time would be different if based on AIR output. The RMS and AIR model versions were not specified by the Beach Plan.

Beach Plan Exposure

Aggregate Liability



Beach Plan Market Share

Homeowners

Rank	Company Group	Homeowners Direct Written Premium			Market Share		
		2010	2007	2004	2010	2007	2004
	Total Private & Beach	2,105,449	1,776,342	1,386,932	100.0%	100.0%	100.0%
	Total Private	1,904,765	1,645,599	1,345,637	90.5%	92.6%	97.0%
1	State Farm Mutl Automobile Ins	377,816	314,171	254,736	17.9%	17.7%	18.4%
2	Nationwide Mutual Group	274,058	257,955	223,385	13.0%	14.5%	16.1%
3	NC Farm Bureau Mutual Ins Co.	263,888	213,326	173,650	12.5%	12.0%	12.5%
4	NC Beach Plan	200,684	130,743	41,295	9.5%	7.4%	3.0%
5	Allstate Corp.	166,028	172,715	130,495	7.9%	9.7%	9.4%
6	USAA Insurance Group	95,553	80,282	55,686	4.5%	4.5%	4.0%
7	Liberty Mutual	90,893	67,049	53,366	4.3%	3.8%	3.8%
8	Travelers Companies Inc.	89,478	87,326	69,796	4.2%	4.9%	5.0%
9	Erie Insurance Group	81,891	63,021	56,595	3.9%	3.5%	4.1%
10	Auto-Owners Insurance Co.	65,473	54,359	45,780	3.1%	3.1%	3.3%

Notes:

1. Data from 2004 - 2010 Annual Statements
2. Data includes DWP from the Homeowners Multi-Peril line of business.
3. Market Share is measured against the combined private and Beach Plan written premium.

North Carolina Rate Level

Rate level in North Carolina is set by NC Department of Insurance (NC DOI) based on industry rate filings submitted by the North Carolina Rate Bureau (NCRB).

- In the Beach and Coastal areas, the NC DOI has approved rate changes significantly lower than those indicated or proposed by the NCRB.
- The residual rate indications are far greater in the Beach and Coastal areas than in the more inland regions of the state.
- One likely driver of high Beach Plan volume is that the rate level in the Beach and Coastal areas is too low for voluntary writers to accept the risk.

North Carolina Rate Bureau

North Carolina Rate Bureau

- Created by the North Carolina General Assembly.
- Promulgates rates for residential property, private passenger auto, worker's compensation, and employer's liability.
- All voluntary insurance carriers are required to be members of the NCRB.
- Historically, Homeowners and Dwelling filings submitted every few years.
- Beach Plan is not a member of the NCRB; however, Beach Plan rates are set by statute at 5% above the approved NCRB rate for wind-only policies and 15% above the NCRB rate for full-coverage policies.
- By state statute, NCRB is required to establish Beach and Coastal territorial definitions so that they can be used to establish Beach Plan premiums that are commensurate with the risk of loss and premiums that are actuarially correct.

2008 NCRB Homeowners Rate Filing Statistics

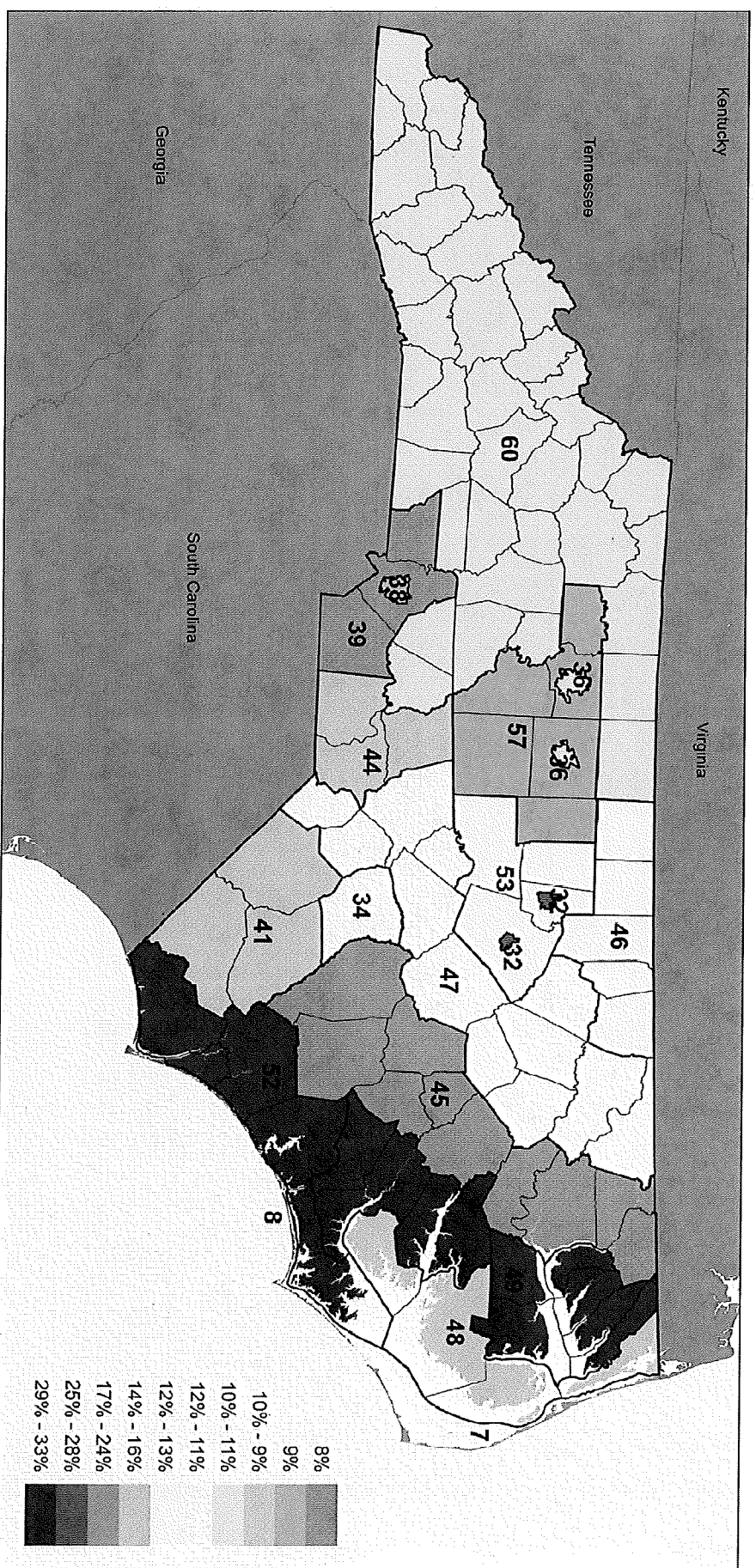
	(1)	(2)	(3)	(4)	(5)	(6)
	5-year House-years (Note 2)	Indicated Rate Level Change (Note 1)	Requested Rate Level Change (Note 1)	Approved Rate Level Change (Note 1)	Residual Indicated Level Change (Note 3)	Average
Beach	83,420	39.9%	39.9%	11.1%	25.9%	> 29.9%
Coastal	641,358	56.7%	56.7%	20.2%	30.4%	> 10.9%
Central	2,837,443	17.4%	17.4%	3.7%	13.2%	> 10.9%
West	5,015,356	8.5%	8.5%	-1.0%	9.6%	> 10.9%
	8,577,577	19.5%	19.5%	4.1%	14.4%	

Using NCRB indications, 2008 NCRB approved rates in the Beach and Coastal areas were estimated to be deficient by approximately 30%, whereas rates in the remainder of the state were 11% deficient.

Notes:

1. Data from NCRB's 2008 Homeowners Rate Filing, effective 5/1/09, which is the latest available.
2. House years are for the calendar years ending 12/31 for 2001 -2005.
3. (5) = [(1 + (2)) / (1 + (4))] - 1
4. Beach: Terr 7, 8
Coastal: Terr 48, 49, 52
Central: Terr 32, 34, 41, 45, 46, 47, 53
West: Terr 36, 38, 39, 44, 57, 60

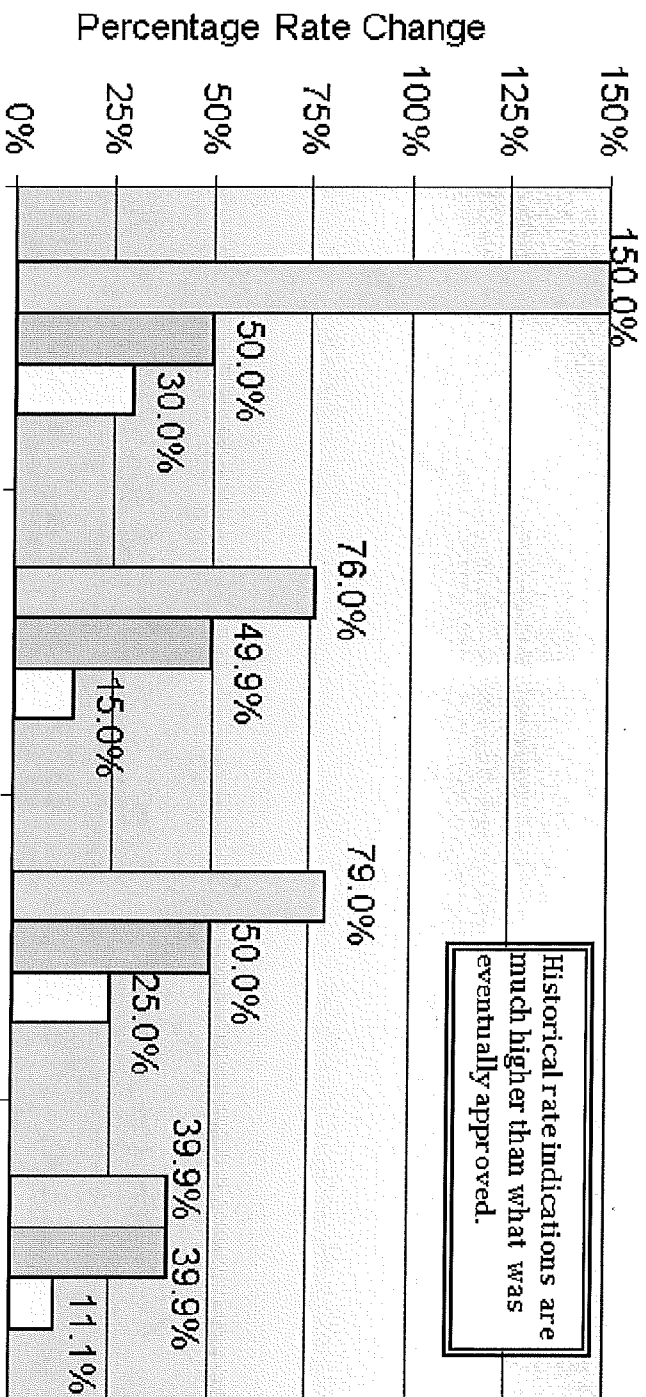
Residual Rate Indication by Territory



Source: 2008 NCRB Homeowners Rate Filing effective 5/1/09

North Carolina Rate Level

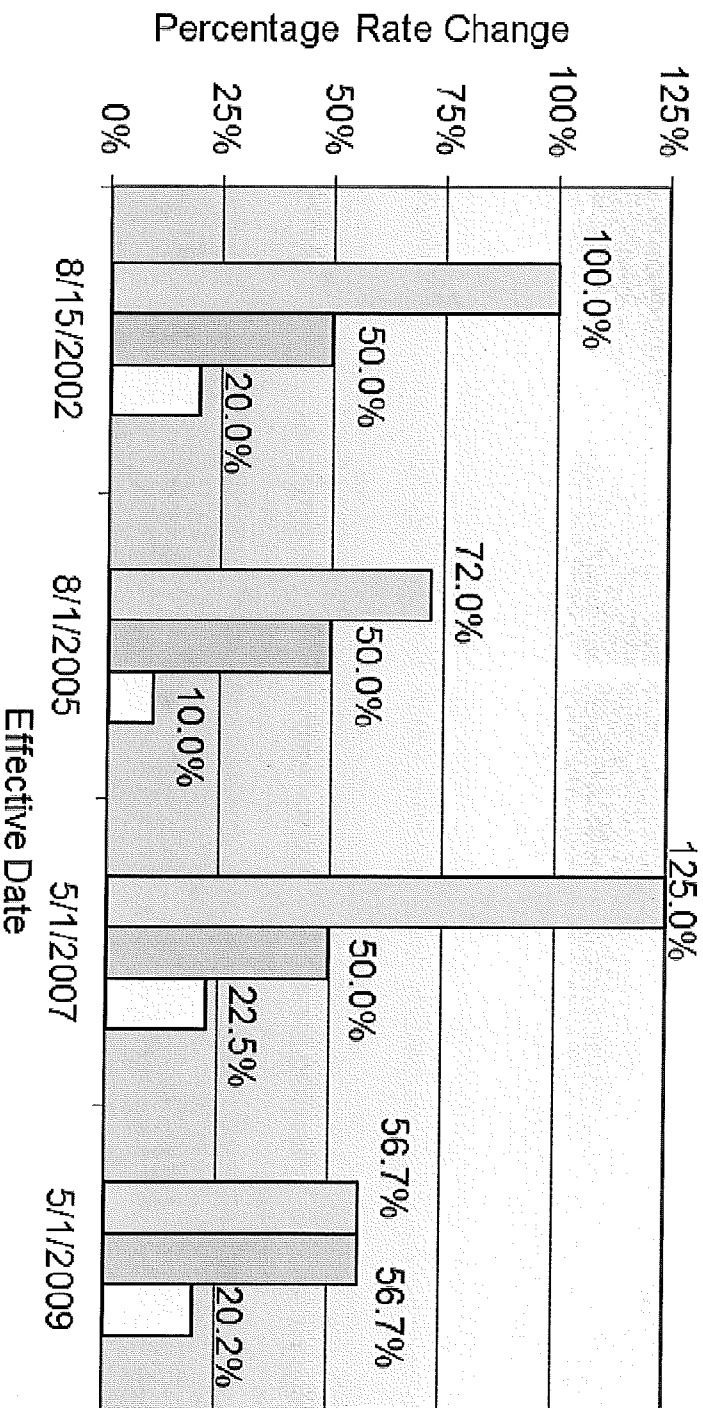
Homeowners Rate Change History Beach Territories



☐ Indicated for Beach ☐ Requested by NCRB ☐ Approved by NC DOI

North Carolina Rate Level

Homeowners Rate Change History Coastal Territories



☐ Indicated for Coastal
 ☐ Requested by NCRB
 ☐ Approved by NC DOI

North Carolina Rate Level

Latest HO rate filing was effective 5/1/2009. Since then rate need has likely increased due to:

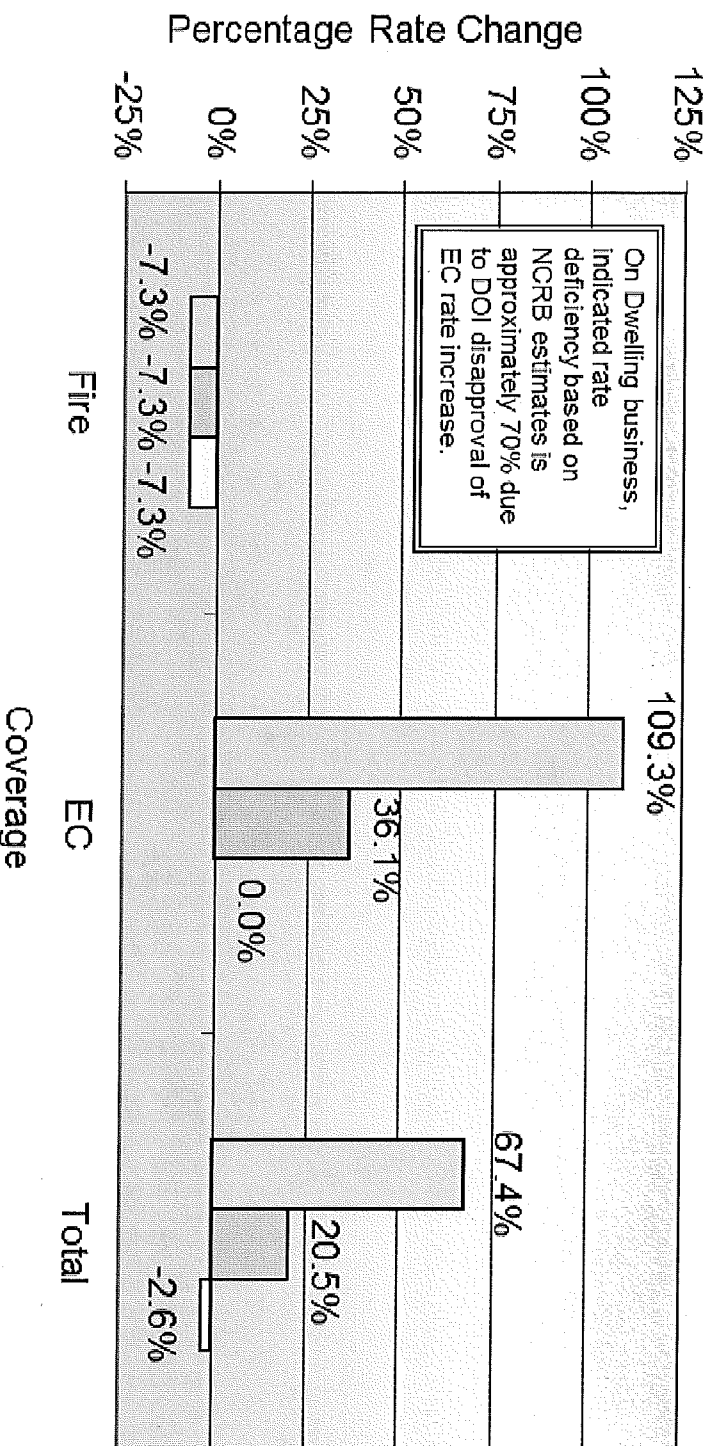
- Loss trend of 5 – 10% a year (based on ISS Fast Track)
- Changes in catastrophe models
- Increased reinsurance costs

Recent NCRB Dwelling rate filing, effective 5/1/2012, received much less than requested from the NC DOI:

- Fire and Extended Coverage (EC) perils analyzed separately
 - EC primarily covers losses from windstorms but also covers theft, vandalism, and other miscellaneous perils.
- Approved rate decrease proposed for Fire
- Disapproved rate increase proposed for EC

North Carolina Rate Level

Rate Change Comparison Dwelling Fire and EC - Effective 5/1/2012



☐ Indicated for DF ☒ Requested by NCRB ☐ Approved by NC DOI

North Carolina Department of Insurance

Department Rate Filing Review

- NCRB Dwelling Fire and EC rate filing, effective 5/1/2012
 - From the NC DOI order
 - “...the Beach Plan is not a member of the Bureau nor does the Bureau have jurisdiction over the rates that the Beach Plan charges; therefore the Beach Plan program is **irrelevant** to this filing which proposes rates for the voluntary market, which is under the jurisdiction of the Bureau. Moreover, there was evidence in this case from both parties that the Beach Plan’s exposures along the coast are significantly greater than the exposures of the voluntary market. Thus, the Beach Plan reinsurance requirements [are] not comparable to the requirements for the voluntary market and would also seem to be irrelevant.”

North Carolina Department of Insurance

Consequences of Department Rate Filing Review

- Ignores statutory connection between NCRB rates and Beach Plan rates.
- Economic realities of catastrophic risk and reinsurance cost are not reflected in approved NCRB HO and Dwelling rates.
- “Catch-22” – Rates in Beach and Coastal areas too low for voluntary market but NC DOI won’t increase rates because voluntary market doesn’t write in the Beach and Coastal areas.
- Resulting imbalance in Beach and Coastal pricing leads to greater risk of assessment through the Beach Plan.
- Catastrophe Recovery Charge is essentially the subsidization of Beach and Coastal policyholders by inland policyholders.

Insurance Industry Effect

How does perceived rate level in North Carolina affect insurer actions? NC Farm Bureau Example:

- About the company:
 - Mutual insurer domiciled in NC; incorporated in 1953; rated A by A.M. Best; writes only in NC.
 - #3 in NC Homeowners market share in 2010 with \$200 million of HO DWP (12.5% of NC DWP including Beach Plan).
- Announcement (Insurance Journal 12/29/2011)
 - NC Farm Bureau will nonrenew up to 28,000 stand alone homeowners policies with recent claims.
 - In addition, NC Farm Bureau is considering nonrenewing up to 70,000 additional Homeowners policies unless legislature makes changes that would allow higher rates.
 - The 98,000 policies represent about 20% of NC Farm Bureau's book of business.

Insurance Industry Effect

NC Farm Bureau Example cont'd:

- Announcement (News & Observer 2/28/12)
 - Removing discounts on 382,000 HO policies (avg. 6% rate increase).
 - Seeking similar increases for Dwelling policies.
 - Excluding wind damage in 15,000 coastal HO and Dwelling policies.
 - Company cited increases in reinsurance costs, concerns over low rate level in NC, and threat to financial stability.
 - NC DOI quotes:
 - “We have been hearing from agents that this has been contemplated by other companies.”
 - “Ultimately these are business decisions that companies are allowed to make.”

Another Example (News & Observer 2/28/12):

- Allstate (#5 in NC HO market) will nonrenew all NC homeowners policies without supporting auto coverage. These underwriting changes are attributed by the company to concerns over profitability.

Conclusions

HB 1305 has led to improvement in Beach Plan:

- Slowed exposure growth
- Increased surplus
- Shifted more risk through reinsurance
- Limited member liability through assessment plan

Beach Plan exposure remains high:

- Covers approximately half of coastal insured property
- At current rate level, private insurers appear unwilling to cover wind exposure in the Beach and Coastal territories.
- Moderately severe storms result in Beach Plan deficits
- Beach and Coastal policyholders subsidized by inland policyholders through Catastrophe Recovery Charge
- Beach Plan continues to pose significant financial risk to member companies and the policyholders in remainder of state.

Conclusions

- NC property writers are signaling concern over profitability of NC as a whole:
 - Rate levels have been suppressed for Homeowners and Dwelling.
 - Beach and Coastal areas most underpriced based on rate filings.
 - Companies must manage their catastrophe risk in order to stay financially stable and fulfill obligations to policyholders.
 - Exposure reductions of larger insurers may shift more risk to Beach Plan and smaller insurers.
 - Chronic underpricing in other states has kept residual market risk unacceptably high.

Other issues post HB 1305

- No recoupment mechanism for Beach Plan assessments.
- No facility specified for Beach Plan Catastrophe Recovery Charge.

Conclusions

Actions that could potentially address the issues identified:

1. Flex Rating Program: Allow automatically approved deviations within some specified band, such as +/-10%.
2. Territorial Deviations: Allow company specific territory definitions with actuarially justified rate deviations.
3. Reinsurance Costs: Enable explicit recognition of reinsurance costs in rates.
 - Net expense: Premium less expected reinsurance recoveries.
 - Necessary to increase insurance capacity.
 - Larger risk margins are needed due to the level of risk and the amount of capital that needs to be held.

Conclusions

4. Catastrophe models: Accept catastrophe models for ratemaking purposes.
 - Models incorporate years of historical hurricane data including frequency, hurricane paths, and property damage.
 - Developed by experts in meteorology and insurance.
 - Estimate of losses due to hurricanes based on up to a million iterations of the model, allowing even companies with low volume to achieve credible results.
5. Beach Plan Assessments: Allow recoupment of \$1 billion paid by Beach Plan member companies through automatic approval of rate changes due only to the impact of Beach Plan assessments.
6. Establish Catastrophe Recovery Charge bonding and recovery process.

Limitations

Limitations and Qualifications:

Use of Report. The data and exhibits in this report are provided to support the conclusions contained herein, limited to the scope of work specified by PCI, and may not be suitable for other purposes. Milliman is available to answer any questions regarding this report or any other aspect of our review.

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Limitations

Limitations and Qualifications (continued):

Data Reliances. In performing this analysis we relied upon data and other information provided to us by PCI, the NCILUA and other publicly available sources. We did not audit or verify this data and information. If the underlying data or information is inaccurate or incomplete, the results of our analysis may likewise be inaccurate or incomplete.

If there are unexplained material defects in the data, it is possible that they would be uncovered by a detailed, systematic review and comparison of the data to search for data values that are questionable or relationships that are materially inconsistent. Such a detailed review was beyond the scope of our assignment.

Uncertainty. We based our results on generally accepted actuarial procedures, the information available to us, and our professional judgment. Our results reflect assumptions such as catastrophe projections, policy exposure growth, loss trend, exposure trend, and risk-sharing associated with the NCILUA and the insurance industry. However, due to the uncertainty associated with the estimation of these assumptions, the effect of other factors such as political and legislative issues, and the inherent limitations of the data, actual results will not develop exactly as projected and may, in fact, significantly vary from the projections.

Reinsurance. Our projections are provided both gross and net of reinsurance. We relied upon the accuracy of reinsurance contract provisions provided via publicly available information sources to determine the extent of recoverables. We assumed that all reinsurance is valid and collectible. We did not examine the various reinsurance contracts to verify the coverage terms. Contingent liability exists with respect to insurance balances that would become liabilities of the NCILUA in the event that any of the reinsurance companies were unable to meet their obligations under existing contracts.